



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR
FEDERAL PROGRAM AND INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133
AND THE STATE SINGLE AUDIT IMPLEMENTATION ACT**

To the Honorable Mayor and
Members of the City Council
City of Durham, North Carolina

Compliance

We have audited the compliance of City of Durham, North Carolina, with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* and the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that are applicable to each of its major federal programs for the year ended June 30, 2001. The City of Durham's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of City of Durham's management. Our responsibility is to express an opinion on City of Durham's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single Audit Implementation Act.

Those standards, OMB Circular A-133, and the State Single Audit Implementation Act require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Durham's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on City of Durham compliance with those requirements.

As described in item 01-1 in the accompanying schedule of findings and questioned costs, the City of Durham did not comply with requirements regarding underwriting requirements related to the commercial loan pool that are applicable to its Housing and Urban Development Economic Development Grant. Compliance with such requirements is necessary, in our opinion, for the City of Durham to comply with the requirements applicable to that program.

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In our opinion, except for the noncompliance described in the preceding paragraph, the City of Durham complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001.

Internal Control Over Compliance

The management of the City of Durham is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Durham's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the State Single Audit Implementation Act.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the City of Durham's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as item 01-1 through 01-6.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major Federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 01-1 to be a material weakness.

This report is intended solely for the information and use of the City Council, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specific parties.

Cherry, Bekaert & Holland L.L.P.

Greensboro, North Carolina
October 19, 2001